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## Letter Ruling 93-8: Security Corporation Classification; Mortgage-backed Securities

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June 14, 1993

You have requested a letter ruling on behalf of \*\*\*\*\* ("Corporation"). Your question is whether certain mortgage-backed interests ("Interests") constitute "securities" within the meaning of G.L. c. 63, § 38B.[\[1\]](#)

### I. FACTS

The facts as set forth in your ruling request are as follows. Corporation is a wholly-owned subsidiary of \*\*\*\*\* ("Parent"). Parent is a mutual holding company organized under Massachusetts law. In addition to Corporation, Parent owns a controlling interest in \*\*\*\*\* ("Bank") and several other subsidiaries (collectively, with Parent and Bank, the "Affiliates"). Bank is a stock savings bank chartered in Massachusetts.

Corporation intends to acquire the Interests: (1) in purchases on the open market, (2) in arm's length purchases from Affiliates, or (3) from Parent as a capital contribution. All Interests acquired from an Affiliate will have been purchased originally in the open market. Moreover, no Interest will have been originated by an Affiliate, and no Interest will be backed by loans or mortgages entered into by an Affiliate.

The Interests are as follows:

1. Government National Mortgage Association ("Ginnie Mae") pass-through certificates (GNMAs). GNMAs are shares in pools of mortgages underwritten by federal agencies. They are issued by federally approved institutions and are fully guaranteed by Ginnie Mae.
2. Federal National Mortgage Association ("Fannie Mae") pass-through certificates (FNMAs). FNMAs are shares in pools of mortgages purchased by Fannie Mae. Fannie Mae issues FNMAs and partially guarantees them.
3. Federal Home Loan Mortgage Corporation ("Freddie Mac") mortgage participation certificates (FHLMCs). FHLMCs are shares in pools of residential mortgages purchased by Freddie Mac. Freddie Mac issues FHLMCs and partially guarantees them.

4. Collateralized Mortgage Obligations ("CMOs"). The CMOs are pay-through bonds that direct the payments on an underlying mortgage pool to obligations of different maturities paying different rates. Unlike pass-through certificates, which "pass through" mortgage payments pro-rata, the payments on the CMOs are allocated based upon the terms of the obligation.

5. Interests in Real Estate Mortgage Investment Conduits ("REMICs"). The REMICs confer part ownership in entities holding a fixed pool of mortgages.

Each of the Interests confer part ownership in a pool of mortgages and the resultant cash flows. The policy behind the creation of the Interests is to convert single mortgages into pools of safer, more liquid investments. This policy is intended to help stimulate mortgage lending by increasing the source of lendable funds.

Each of the Interests is actively traded on established secondary markets. In addition, all servicing and managerial work required in connection with the Interests is to be performed by parties unrelated to Corporation and Affiliates.

## II. DISCUSSION

Under G.L. c. 63, § 38B, Massachusetts extends favorable tax treatment to any domestic or foreign corporation which is "engaged exclusively in buying, selling, dealing in, or holding securities on its own behalf and not as a broker." In applying this requirement to specific facts, the Department views whether the instruments in question constitute "securities" and whether the actions contemplated are to be taken for investment purposes. See State Tax Commission v. PoGM Co., 369 Mass. 611, 612-13 (1976) (interest in question not the type of security which the Legislature contemplated in G.L. c. 63, § 38B); Industrial Finance Corp. v. State Tax Commission, 367 Mass. 360, 366 (1975) ("We hold that to qualify under G.L. c. 63, § 38B, the corporation engaged exclusively in buying, selling, dealing in, or holding securities on its own behalf must do so for investment").

The CMOs and REMICs resemble securities in the conventional sense, since the CMOs are structured as bonds and the REMICs are structured as part ownership in an entity. Moreover, the GNMA's, FNMA's and FHLMC's each possess characteristics which would cause them to be treated as securities for purposes of federal securities law. See Union Home Loans, Exchange Act Release No. 19346, [1982-1983 Transfer Binder] Fed. Sec. L. Rep. (CCH) P. 83,808 (Dec. 16, 1982); Bank of American National Trust and Savings Association, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) P. 81,193 (April 19, 1977). See also Gen. Couns. Memo 39626 (April 29, 1987) (citing authorities).

While the definition of a "security" for purposes of G.L. c. 63, § 38B is not necessarily identical with that operative for other purposes, see PoGM at 612-13, we think that the Interests meet with the security corporation test. In this regard, we stress that: (1) the Interests were not originated by, and are not backed by any of the obligations of, Bank or the other Affiliates, (2) none of the servicing or managerial efforts to be performed in connection with the Interests is to be performed by Bank or the other Affiliates, and (3) the Interests are actively traded on established secondary markets.

## III. CONCLUSION

The Interests are securities within the meaning of G.L. c. 63, § 38B and may be acquired and held by a security corporation under that section, provided they are acquired and held exclusively for investment purposes.

Very truly yours,

/s/Mitchell Adams

Mitchell Adams  
Commissioner of Revenue

MA:HMP:mtf

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[\[1\]](#) More specifically, you request a broad ruling that all mortgage-backed interests qualify as "securities" under the security corporation provision. Since we cannot rule on hypothetical facts, we limit our ruling to the mortgage-backed interests which you specifically described in your request.